



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting officer
Mkhondo Local Municipality
P.O Box 23
Piet Retief
2380

Date: 3 December 2019

Reference: 02394Reg 18/19

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mkhondo local Municipality for the year ended 30 June 2019

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa [section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)].
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the Municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
6. Please notify the undersigned Business Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.

7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



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Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Mkhondo Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Mkhondo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Mkhondo Local Municipality as at 30 June 2019, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (Dora).

Basis for qualified opinion

Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence for the re-assessment of the useful lives of assets, as the municipality did not have adequate systems in place to support the re-assessment. I could not confirm the amounts by alternative means. In addition, there were differences between the conditional assessment performed by the municipality and what was reported in the fixed asset register for some of the assets, which resulted in assets being valued incorrectly. Furthermore, the municipality did not maintain proper systems to record and account for all assets under its control, as there were assets that could not be traced to the fixed asset register. I was unable to determine the full extent of the misstatement, as it was impracticable to do so.
4. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment stated at R1 612 251 574 (2017-18: R1 655 878 965) and depreciation stated at R136 727 239 (2017-18: R131 023 751) in notes 10 and 37 to the financial statements, respectively. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.

Investment property

5. I was unable to obtain sufficient appropriate audit evidence for the re-assessment of the useful lives of assets, as the municipality did not have adequate systems in place to support the re-assessment. I could not confirm the amounts by alternative means. In addition, there were differences between the conditional assessment performed by the municipality and what was reported in the fixed asset register for some of the assets, which resulted in assets being valued incorrectly. I was unable to determine the full extent of the misstatement, as it was impracticable to do so.
6. Consequently, I was unable to determine whether any adjustment was necessary to investment property stated at R18 185 455 (2017-18: R19 418 743) and depreciation stated at R278 681 (2017-18: R903 552) in notes 9 and 37 to the financial statements, respectively. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.

Context for the opinion

7. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
8. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and parts 1 and 3 of the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
9. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty relating to going concern

10. I draw attention to the matter below. My opinion is not modified in respect of this matter.
11. I draw attention to note 59 to the financial statements, which indicates that the National Treasury intends to invoke section 216(2) of the Constitution due to the failure to adopt a funded budget. As stated in note 59, this event indicates that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matters

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material losses – electricity

13. As disclosed in note 57 to the financial statements, material electricity losses of R40 369 130 (2017-18: R42 404 706) were incurred, which represented 32% (2017-18: 37%) of the total electricity purchased.

Material losses – water

14. As disclosed in note 57 to the financial statements, material water losses of R616 862 (2017-18: R1 271 460) were incurred, which represented 22% (2017-18: 31%) of the total water purchased.

Material impairments

15. As disclosed in note 6 to the financial statements, the consumer debtors balance was significantly impaired. The allowance for the impairment of consumer debtors amounted to R359 067 324 (2017-18: R292 717 020), which represented 90% (2017-18: 88%) of the total consumer debtors. The contribution to the provision for debt impairment was R66 350 304 (2017-18: R64 274 047).

Unauthorised expenditure

16. As disclosed in note 54 to the financial statements, the municipality incurred unauthorised expenditure of R256 242 032, due to overspending of the approved operational budget.

Fruitless and wasteful expenditure

17. As disclosed in note 55 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R17 238 719, due to interest charges on overdue accounts.

Irregular expenditure

18. As disclosed in note 56 to the financial statements, the municipality incurred irregular expenditure of R32 036 822, as it did not follow a proper tender process.

Other matter

19. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the financial statements

21. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
22. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

23. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
24. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

25. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
26. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

27. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2019:

Objective	Pages in the annual performance report
Objective 3.1 – provision of basic services	xx – xx

28. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the usefulness and reliability of the selected objective are as follows:

Objective 3.1 – provision of basic services

Various indicators

30. I was unable to obtain sufficient appropriate audit evidence to validate the existence of systems and processes that should enable reliable reporting of actual service delivery against the indicators below. This was due to a lack of technical indicator descriptions, proper performance management systems and processes, and formal standard operating procedures or documented system descriptions that predetermined how the achievement would be measured, monitored and reported. I was unable to validate the existence of systems and processes by alternative means.

Indicator description	Reported achievement
% of main access road constructed in Sandbank village	45%
% M ² of storm water drainage constructed	96%
% of Waste Water Treatment Work Constructed at eThandukukhanya	0%

Various indicators

31. I was unable to obtain sufficient appropriate audit evidence to support the reported achievement of targets in the instances below. This was due to a lack of technical indicator descriptions, proper performance management systems and processes, and formal standard operating procedures or documented system descriptions that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievement of the indicator by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement as reported in the annual performance report.

Indicator description	Reported achievement
Number of street lights maintained	851
Megaliters of water provided to communities through water treatment works/water tankers and boreholes	5 800

Various indicators

32. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievement of these indicators was as follows:

Planned target	Reported achievement	Audited value
Number of meter boxes replaced	24	30
Number of mass refuse container trips made	867	722
% of graves prepared	100%	90%

Other matters

33. I draw attention to the matters below.

Achievement of planned targets

34. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 32 of this report.

Adjustment of material misstatements

35. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of provision of basic services. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

36. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
37. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of payables and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
39. The annual financial statements were not submitted to the auditor-general, for auditing, within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
40. Written explanations setting out the reasons for the failure to submit the financial statements within two months after the end of the financial year to the auditor-general, for auditing, were not tabled in the council as required by section 133(1)(a) of the MFMA.

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
42. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred, as required by section 65(2)(b) of the MFMA.

43. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R256 242 032, as disclosed in note 54 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by expenditure exceeding the budgeted amount due to poor controls over the monitoring of the budget.
44. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R17 238 719, as disclosed in note 55 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was as a result of interest paid on late payments to suppliers.
45. Reasonable steps were not taken to prevent irregular expenditure amounting to R32 036 822, as disclosed in note 56 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the Preferential Procurement Regulations.
46. Expenditure was incurred in excess of the approved budget, in contravention of section 87(8) of the MFMA.

Asset management

47. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
48. Capital assets were disposed of without the municipal council, in a meeting open to the public, having decided on whether the assets were still needed to provide the minimum level of basic municipal services and having considered the fair market value of the assets and the economic and community value to be received in exchange for the assets, as required by section 14(2)(a) and 14(2)(b) of the MFMA.

Procurement and contract management

49. Some of the contracts and quotations were awarded to bidders based on pre-qualification criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of preferential procurement regulation 4(1) and 4(2) of 2017.
50. Some of the commodities designated for local content and production were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by preferential procurement regulation 8(5) of 2017.
51. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.
52. Some of the bid documentation for the procurement of commodities designated for local content and production did not stipulate the minimum threshold for local production and content, as required by preferential procurement regulation 8(2) of 2017.

Consequence management

53. Unauthorised expenditure amounting to R256 242 032 was not authorised through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Other information

54. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the financial statements, the auditor's report thereon and the selected objective presented in the annual performance report that has been specifically reported on in this auditor's report.
55. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
56. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
57. If based on the work I have performed, I conclude that there is a material misstatement in this other information, I am required to report that fact.
58. I have nothing to report in this regard.

Internal control deficiencies

59. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
60. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
61. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
62. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
63. Management did not review and monitor compliance with applicable laws and regulations.

64. The audit committee and internal audit function did not positively influence the audit opinion, as their recommendations were not implemented effectively.

Auditor-General

Mbombela

3 December 2019



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected objectives and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.